November 2023 Live Event-AICA Fall Roundtable Interval Fund Track Panel #4; “Attractive Funds for Access to Unique Strategies”

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James J. Ryan, Partner & Head of Business Development with Destra, moderates the fourth panel of the AICA November 15th, 2023 live event; “Attractive Funds for Access to Unique Strategies”. Read the transcript below to hear the discussion among Mr. Ryan and panelists Ryan Crewe, Vice-President with The Private Shares Fund, James Bruno, Managing Director and Head of Product Development and Advocacy with Brookfield Oaktree Wealth Solutions, and Jake Schultz, Partner and Director, Portfolio Oversight & Analytics with Destra.




James J. Ryan Ryan Crewe James Bruno Jake Schultz

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James J. Ryan: Partner and head of business development with Destra Capital Investments. To my immediate left is Ryan Crewe with Liberty Street Funds, in the middle here is Jim Bruno with Oaktree, and to the far left is Jake Schultz with Destra Capital Investments as well. We’re going to segue into interval funds, and we’re going to talk about the importance of not only the structure but also how shareholder value can be enhanced with these various strategies in an interval structure.

So with that as an overview, let me turn it over to each of my colleagues here on the panel and just start with a question. Let’s start with you, Ryan, as far as could you please introduce yourself and your role? Also the strategy we're going to discuss today, and then of course why an interval fund fits that strategy best.

Ryan Crewe: Great to be here. My name is Ryan, I'm on the institutional team at Liberty Street Advisors, we're the delegated investment manager of the Private Shares Fund. The Private Shares Fund is a closed-end interval fund that provides access to late-stage venture and growth equity. We've been around for coming on 10 years, and around a billion dollars in our US fund. The whole premise behind why an interval fund is that we wanted to democratize access to an asset class which historically was inaccessible for the non-accredited client base.

What we've built today is a portfolio of diversified companies across a range of sectors, and we're pretty proud of what we've built. I think the unique thing about our strategy and our approach to an interval fund is that we're dynamic in how we allocate, we can invest in primary funding rounds, secondary funding rounds, and we're willing to work with intermediaries who can provide us access to common shares or preference shares. Essentially we run a best ideas fund, and we're looking to open up access to an asset class which historically was only four institutions.

James J. Ryan: Thanks Ryan. Jim, same question.

James Bruno: Thanks for having me, first of all. I run product development at Brookfield Oaktree Wealth Solutions, and Brookfield Oaktree Wealth Solutions is basically, call it the wealth arm of the two firms. Brookfield owns 72%, maybe higher now, of Oaktree, and they'll probably stay separate for obvious reasons, I don't think that Oaktree would benefit being folded into Brookfield given their reputation. We created a wealth unit that basically sells into to the advisor network for both businesses, and then we also create more democratized product, so each of them have their flagship funds that are institutional but we're creating products to bring down to the accredited investor space.

I joined in January, I was previously at Morgan Stanley for 15 years doing product development in the alternatives group of the wealth business and so I'm going to talk about Oaktree Diversified Income, which is an interval fund. The reason it fits into that structure is similar to you, it's a flexible mandate, and so it can do high yield, it can do loans, it can do CLOs, and it also does private credit. And so the private credit aspect of it works nicely in the interval fund structure as opposed to a mutual fund, and there's other benefits as well in terms of leverage or whatnot. But essentially it is a fund, not surprising, it's very diversified across public and private credit to generate income and capital appreciation secondly. So it's a relative value fund across all of the, I would say multi-sectors of the Oaktree business, so it takes advantage of everything that Oaktree is doing on the credit side. Gives about a 9% yield, currently very low levered at 13%, given I think the defensive nature of the portfolio. I'll stop there and we can continue talking about the funds.

James J. Ryan: Apologies, I combined Brookfield and Oaktree into Oakfield. Of course I knew it was Brookfield. Jake, can you pick up on those questions as well?

Jake Schultz: Hello all, my name is Jake Schultz. I'm with Destra Capital and I'm on the product management team there, one of our product specialists working closely with our subadvisors for our sub-advised mutual fund products. The fund we're discussing today is the BlueBay Destra International Event-Driven Credit Fund. It's a closed-end interval fund and the idea or the main concept of the fund is investing in event-driven credit. We'll probably dive deeper into that a bit later, but essentially it's investing in liquid and a component of illiquid stressed, distressed, and special-situation credit companies, mostly corporate, high-yield and levered loans.

The fund, international by name, it's a global mandate, predominant focus in Europe. BlueBay Asset Management, they're a subsidiary of Royal Bank of Canada, RBC Global Asset Management, headquartered in London, and so their focus tends to be a bit more on developed markets over in Europe. Why we think the fund makes sense, the fund structure of an interval fund for this strategy. If you were to ask those over in Europe, they're not familiar with interval funds, they actually don't really have that type of structure.

But as Duncan and the PM team would say, it's really a brilliant structure for capturing not really that illiquidity premium as much that you hear in interval funds, investing in more private assets, private credit, private real estate. But really it's that horizon premium of being able to invest capital in a company that for whatever reason the value's depressed, a mispriced asset, mispriced risk, that BlueBay's able to invest capital in with a potential catalyst to kind of unlock capital appreciation in that company. So it's a credit fund, so 80% in credit, income is a component of that, but really the focus is total return paying quarterly distributions.

James J. Ryan: Thanks Jake. I'm going to move now to questions that are more specific to each of your strategies. Ryan, I'm going to start with you again. What is your current assessment on late-stage venture and the asset class as a whole?

Ryan Crewe: Look, to summarize it, it remains challenging. It's been a very hard couple years post-Covid in late-stage venture and growth equity. Our assessment is that in general it's bifurcated, we're seeing a massive divergence between what we think are high-quality institutional companies. These businesses are generating sustainable growing revenues, they're on a pathway to profitability, if they're not already profitable. They have a differentiated business model, they're entering new markets, and look, these businesses continue to raise up rounds or flat rounds. They're coming to market selectively, and in some cases as investors who have capital we're able to invest on better terms, better liquidation pref. We have warrant coverage and whatnot.

And look, the secondary market has been a massive focus of us over the past two years. As the primary market has really slowed for fundraising, we're able to pick up stakes in very high-quality businesses at very attractive discounts so we can potentially dollar cost average into these positions, bring down our cost base, and continue to support a thriving ecosystem. On the other side of that, there's a massive tale of poor performing companies, these are businesses which were started in a zero interest rate environment, these businesses have no capital discipline, they're poorly run, and they're essentially on a trajectory for multiple down rounds, and in some cases recapitalizations.

So in summary, our view is that the market is challenging but patient investors who are dynamic and have the ability to invest through the cycle remain very bullish. So we look forward to continuing to raise assets in our fund and we just say to people, just look through some of the basic media coverage because not every venture-backed company is doomed.

James J. Ryan: Thanks Ryan. Jim, working off your opening remarks, could we go in a little bit deeper into the fund? What kind of credits are you investing in? And again, the objective and how you try to maximize shareholder value?

James Bruno: Yeah. So again, this is a flexible mandate, so call it a tactical allocation fund across public and private credit. It's a global fund and so they can allocate across bonds, loans, private credit, structured credit, and that's really based on I would say relative value is really how they shift it around, and also based on just general market cycles and market conditions. Not surprising with Oaktree, it's a value-oriented fund, and the reason that it was created two years ago was really to give folks another alternative path to income, and secondarily as capital appreciation.

So as I said, it's yielding about 9% cash-on-cash yield, and so if you look at competitive products, if you look at direct lending, you're probably getting somewhere around the same type of return, maybe a little bit higher, but this is something to add in terms of I would say a diversification away from other things where you can get a good yield. It's very diversified, it's got 400 positions.

I think right now in terms of high-yield and emerging market, it's probably about, I don't know, at 16%? And then if you look at senior, I would say syndicated loans, there's a big allocation there, about 25%. Private credit, so again this is more direct lending, there's probably about a 30% allocation there. And then when you look at structured credit, real estate debt right now is very attractive, and then second within that category is just CLO type of instruments. So again, very diversified and there's movement again in terms of relative value. It is focused right now predominantly in the United States, so I would say 85% of the portfolio is in the US and 15% externally.

James J. Ryan: Thanks, Jim. Jake, let's go a little deeper into the term event-driven, can you speak to that? And then also what kind of opportunities are you seeing in the event-driven space right now?

Jake Schultz: Absolutely. So as I mentioned a bit earlier, event-driven credit is investing essentially in discounted prices of bond securities, as BlueBay classifies them, they're either stressed, distressed or a component of restructuring of credit. So as BlueBay builds the portfolio, they're looking from a bottom up fundamental view, really not as much sector-oriented, although there will be headwinds to certain sectors that create more opportunities.

For example, energy sector over the last two years, there was a mass overinvestment in the energy space in the late 2000s, 2010s, a lot of companies that had been overinvested in was kind of an unloved sector for years. And then as inflation reared its head, Russian invasion of

Ukraine, energy was something that these vessels were not going to wave the magic wand of going to EV, that you still need oil, and so offshore dive support vessels, a lot of these companies became under pressure, they had to restructure their debt.

BlueBay was able to take advantage of certain companies from that sector, same thing with shipping. But ultimately they're buying discounted securities in the credit space, in situations where if it's just a stressed name, it's still paying a current coupon, so income is generated but a view that that's security likely to appreciate towards par based on some catalyst that will help that value appreciate.

As you get further into the distressed space, more bonds and loans trading sub-50 cents on the dollar, you're looking at a situation where BlueBay might actually invest in that company knowing that has either defaulted or is likely to default and need to go through some restructuring situation where with their experience they're able to sit in on ad-hoc working groups. Help propose restructurings to these companies, and ultimately not only inject new money as a senior secured level of that company but also in certain instances as well receive post-re-org equity of that company, again offering that ability to receive income on the senior secured level, very close to the asset value.

But then also if that equity unlocks value, as BlueBay believes, I think Scott said it earlier from Nuveen on one of the panels, over the next one to three years there's going to be a lot of companies that are good companies but they have crappy balance sheets. As he said, so it has a reason to exist, and if they can figure out their balance sheet, that value can unlock for the company.

James J. Ryan: Thanks Jake. Ryan, back to you in regards to maybe going deeper as well into what sectors in particularly in the late-stage venture class do you think offer the most opportunity today? And where are your investors looking for opportunities?

Ryan Crewe: Yeah, so I didn't mention earlier but we are a US-focused fund, we focus on the US market almost exclusively, but we invest in technology, we see ourselves as a deep technology fund. We want to focus on areas of the market where disruption is taking place, and we refer to this as disruption 2.0. These are sectors where we see sustainable revenues, new market entry for a lot of the companies which we back, so we focus on areas such as the space economy. We're extremely bullish, we have a number of positions related to the exploration of space.

Cybersecurity and AI, very hot names right now. We have some long-term bets in that part of the market, we've been allocated to that for quite some time. Health tech is extremely exciting to us, there's a massive requirement for obviously more investment in that part of the market and there's a lot of technology enablement which we think is going to continue to take place. Rounding that out with mobility, robotics, and logistics, we think the digitization of these sectors is going to continue and there's a lot of major players who have really grown into quite substantial businesses.

James J. Ryan: Thank you, Ryan. Just like ever panel today's probably going to address some question or have some opinion on interest rates, Jim, in regard to interest rates, can you give us an overview? Not only how the portfolio has worked through the higher interest rate but what your forecast is and just what is the interest rate risk and the credit risk in the portfolio today?

James Bruno: Yeah. Look, I think Oaktree's view is that rates will stay higher for longer. Howard Marks said, I don't know if anybody reads his memos, so if you don't I would suggest you read his memos, he writes them quite frequently. One of the recent ones it was called *Sea Change*, which is basically we had rates going down forever and now they're back up, we do think that they'll stay higher for longer. People are now getting compensated on the credit side for, I would say the risk-return is very good. And the returns like I said, 9% yield, if you look at high yield, where that's trading, if you look at direct lending you're talking 9-10%, asset based lending probably could get even maybe a little bit of a higher yield.

So these are returns that are competing with equity returns, and you are seeing folks, and look, everybody has a different allocation but you are seeing people move money to credit because they're actually getting paid well for the risk that they're taking. We get new sheets every day on what's going on, it's amazing, it seems like every other article is about the growth of private credit and direct lending. So there is a lot of growth, but you've got to balance that, you still have to do very good credit underwriting, that's fundamental to anything. And so you want to make sure that if you're on the private side, you want to get the right covenants and protections when you're lending money.

The interesting side of it, which kind of leads into your discussion is you had all these companies that borrowed at very low rates, and they borrowed a lot when rates were low, and these are floating-rate instruments and now the interest rates are much higher. So there's a lot of companies out there in the private space that their interest costs are tremendously higher and there's a maturity wall coming over the next couple of years, and we'll see if they're going to be able to refinance that debt. I think it will lead to probably more distressed opportunities.

James J. Ryan: Thanks Jim. Jake, similar type of question. You spoke earlier about distressed and stressed companies and how that fits in the composition of the portfolio. How is BlueBay managing credit risk? Certainly European marketplace is different, interest rates are higher there, how does that play higher into risk management, and I guess importantly, security selection and portfolio construction?

Jake Schultz: Absolutely. If I could just, I'll pick up on that, but touch on Jim's point that he made about the higher cost of funding. Obviously today it's no surprise to all of us, but these companies that put on debt, high-yield sub-four or sub-five percent, as they come into the wall of refinancing here in the next one to three years; Apollo recently put out a report, I think it was last week or the week before, when you're looking at the number of high-yield companies in the next one to three years that are going to have to refinance their debt, in the US it's around 20%, and that's refinancing at levels that is not 4-5% like it was two, three years ago, it's 8, 10, 12%. The number of companies in Europe that are going to have to refinance in the next one to three years is estimated to be about 45%, so although US certainly has its own issues going on economically, really Europe's a bit further along in that cycle and so that's why BlueBay really feels the opportunity set there is only continuing to grow, so I thought that was a great point that I wanted to just build on.

But in terms of portfolio construction, how BlueBay's looking at the pipeline of opportunities and ultimately determining an entry point for investing, managing that downside, managing that credit risk, Jim, it's a bottom's up portfolio, usually 30 to 50 names, so really not a very broad multi-hundred company portfolio. What they do at each investment upon investment is they're sitting down, they're looking at what is the price of the entry or price today? What is the asset value of the company? Should this company need to go through a restructuring or do the keys need to be handed over, what could we sell the scrap value of that company? What could we ultimately sell those vessels, those manufacturing plants for, worst case scenario as a protection?

So BlueBay tends to invest very senior, often secured, first-lien loans, and very senior in the debt stack to kind of have that asset backing if you will. The companies are often very asset intensive, you're looking at offshore dive support vessels, shipping container companies, auto parts manufacturers, paper manufacturers, so companies that tend to have a reason to exist, they're oftentimes a supplier or the only supplier to some of these companies, and that kind of gives ultimately one pricing power.

In one instance, and won't get too deep into examples, but in one instance it's a German auto parts manufacturer that is the sole supplier to some of the biggest name German auto manufacturers we know. That company was going through a situation where money was actually injected from the auto part manufacturer that ultimately if they don't have these parts their business won't continue. So there's kind of that component of a key business that needs to exist, that helps, while it doesn't ultimately protect the downside in the long tail end, but that's kind of another component that BlueBay's considering as they're investing in these companies, the staying power and pricing power of these businesses.

James J. Ryan: Thanks Jake. I'm going to try to delve now into more about portfolio construction and how each of your funds fit into portfolio construction. Ryan, specifically as far as late-stage venture investing and growth in particular, how does it complement, let's say other securities, other instruments in the portfolio? And why should people look at late-stage venture investing in general?

Ryan Crewe: Yeah, thank you for the question. So look, historically late-stage venture has only been accessible for institutional investors, that's just been the nature of the asset class, and essentially what we've tried to do, as well as some of our peers, is create a structure which makes it a lot more open and easy. So the interval structure means that we can provide access for nonaccredited investors, they can get access to our fund for as little as $2,500, and it can purchased via a ticker, our ticker is PRIVX, which is available on a lot of exchanges.

The main reason why we think it fits into portfolio construction, apart from the access piece which we're opening up, is the upside opportunity. Over 75% of companies with revenues over $100 million are private companies. Another interesting statistic is that the average life in the private markets of a company is now 13 years, two decades ago that was four years. So just looking at those two statistics, if you're not taking advantage of investing in private market companies and just waiting for them to be public companies, you're missing out on a lot of the opportunity.

We're increasingly seeing more funds in this space, we're seeing more investor appetite, and look, from our perspective this is becoming a much more investable part of the market. Companies within our portfolio are generating upwards of $50 million in revenue at the minimum, but many of them are generating hundreds of millions if not billions of dollars of revenue. These are businesses with many billions of dollars in enterprise value and they have global clients, they operate in multiple different geographies.

So I think from a portfolio construction perspective, they tick all the boxes we think, the upside can be great, it just requires active management. And in terms of where this can sit in a portfolio, we've seen everything, obviously largely in alternatives but increasingly we're seeing late-stage venture, and our fund specifically is a proxy for global midcap, albeit with much lower volatility. So yeah, we see it used very widely.

James J. Ryan: Great, thank you Ryan. Jim, same question in part but also maybe step out and discuss how you think the strategy will play out in 2024. Is there anything in your own internal forecasts in how 2024, whether it's interest rates or just economic conditions, how do you see the fund performing and where does it fit as well in portfolio construction?

James Bruno: Yeah. So 2024, look, I think it's anybody's guess as to whether we have a recession. If we do, I think that it's going to be led by the Fed. The economy seems to be fairly robust and we could come in for a soft landing here and consumer prices came in fairly low, so again, I think the Fed is going to continue to press hard. And even if we have a recession it's probably going to be a mild one, so I don't know that we're looking at any radical changes in 2024 quite frankly.

So in terms of the portfolio, it's really again going to come down to just where we see relative value across the landscape, in terms of what we do. When you look at portfolio construction, again I said this before, this is a very diversified portfolio, so everybody has a credit allocation and everybody's allocation looks a little bit different; but if you're looking at direct lending, and we do direct lending so it's not a knock on direct lending, we actually think it's a fabulous space, but that's one focus if you look at asset-based lending, if you look at high yield. But what this can do is, again given it's very diversified and across multiple products and geographies, it can be a diversifier, and you're getting paid pretty well in terms of a 9% yield for that diversification.

James J. Ryan: Thanks, Jim. Great insight. Jake, you touched on this before, although briefly, that they portfolio includes both public and private investments. Can you speak to how both the public and private side is sourced? And at the end of the day, is there an effort to have a balance between private and public or is it just best opportunity sets?

Jake Schultz: Great question, Jim. A lot of times the fund is grouped into private credit, although that's oftentimes we try and walk people back, that's not what this fund really is. Today it's some 90% + of public credit and securities, either liquid on-the-run high-yield bonds or securities that are traded over the counter through broker quotes. In terms of the private space, we think there's certainly opportunities for that but you're locking up capital for generally a bit longer.

BlueBay feels that in the current environment today, and even as they're looking out to '24 and '25 with the wall of refinancings, a likely uptick of defaults, not a large spike. As we heard from the panelists earlier, there's still plenty of opportunities in the public space and BlueBay is very active there. It's a portfolio that they'll hold these names, and once the value's unlocked, if they buy a security at 60 cents on the dollar, it trades up to 92, based on the original asymmetry of where the price of the security was bought, they liked it but when it's at 92 you don't need to hold on till par, right? So there's a lot of opportunities they're cycling through and they're likely going to continue to play in the public space for the next several years would be the indication from the team.

James J. Ryan: Right, thank you, Jake. Questions now from the audience on any of the thoughts that panelists have shared with you?

Audience Question: I have a question. Why do you think that the interval fund [inaudible]?

James J. Ryan: For those of you that didn't hear, why is the interval fund structure the best to maximize shareholder value under the individual mandates that all of the panelists have talked about?

James Bruno: As opposed to a mutual fund structure?

Audience Question: Open or closed-ended.

Jake Schultz: I could take that. I think in terms of the open end, the strategy really, the time horizon of daily in and out of flows for an open end, it really doesn't lend to being able to hold the securities that BlueBay's investing in for this strategy specifically. On the spectrum of a closed-end fund, certainly that's a viable vehicle. I think there are, as most all of us are familiar, the closed-end fund market, IPO market's pretty dried up currently, there's a lot of discounts.

So I think coming to market is one issue, but also on the note of the interval fund, I think it's very exciting for the team at Destra and BlueBay, being in the phase that the fund's over five years old, very strong performance, we have very healthy flows today into the fund, and being able to put that money that's new money to work at very discounted companies and securities, it's really a great time, and that's why we think the vehicle's kind of a brilliant structure for the strategy.

James J. Ryan: Jim and Ryan, thoughts on why the interval for your mandate?

Ryan Crewe: Yeah, look, for us again it comes back to access. Venture capital has historically been, as I mentioned earlier, the domain of institutional investors, and for us we wanted to create a strategy which was easily accessible. We worked with a regulator to find the best structure for what we wanted to do, and we launched this fund in 2014, so we've been doing it for now coming on 10 years. Providing a vehicle in which investors can access for $2,500, again via the ticker, that was increasingly important.

We obviously want to be able to accept daily applications, and the interval fund offers us that liquidity mechanism, so we offer 5% of the fund to be redeemed, 5% of the NAV. So look, for us it was about finding the right structure, because we knew what we wanted to build in terms of our portfolio construction. That's the structure we chose and we would probably do it again in the same structure. It was a little bit unique and we're pretty happy with the reason why we chose an interval fund.

James Bruno: Just to add quickly, I agree with everything that was said. As you start to add some private securities, the interval fund is a good mechanism, and it's either going to be an interval fund, a tender-offer fund, then you have BDCs and private REITs. We're starting to see people invest in these structures as opposed to a commitment-based fund, so more institutional where it's a draw down capital, and they're willing to give up a little bit of return for that liquidity that exists. We all know that, I guess it was last year or the year before, some of these REITs ran into some problems and they had more redemptions than they could meet, so that's always a possibility, but the structure I do think just works well for a lot of investors.

James J. Ryan: Any other questions? Very good. I want to first of all thank the panelists, Jake, Jim, and Ryan, for not only providing some insights into their mandates but being concise and having a very balanced panel as far as equal time, so thank you for again being succinct and providing great insights.

I also want to mention just from an interval fund standpoint, obviously we've seen prolific growth in the structure over the last 10 years, and more or less just supporting what the panelists said, I think one of the great opportunities that interval funds have is that you can take hedge fund type of strategies or alternative strategies and really maximize value because of the ability to control capital. I'm sure speaking for all three panelists, even on the quarterly tenders, they have lending facilities that allow them to stay fully invested through all markets. And I think that's why you're seeing so many alternative strategies come to market today in an interval structure, because it does afford the managers opportunity to put capital to use on strategies that may play out over three, six, nine month and two-year, three-year periods.

With that said, I think I'm keeping you from lunch, so let me turn it over to John for any remarks before lunch but thank you for your attention today in our panel.

Recorded on November 15, 2023.

Click the link below to go to the home page of Active Investment Company Alliance to learn more:

https://AICalliance.org/

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A fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and it may be obtained by calling 855-862-5873 or visiting www.brookfieldoaktree.com Read the prospectus carefully before investing.

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